

ORAL TESTIMONY OF
DEPUTY UNDER SECRETARY OF DEFENSE
(INDUSTRIAL POLICY)
BEFORE THE UNITED STATES HOUSE
COMMITTEE ON ARMED SERVICES
SUBCOMMITTEE ON PROCUREMENT
March 19, 2002

Mr. Chairman and Members of the Committee:

Thank you for inviting me here today to talk with you about the current and future ability of the US defense industry to meet our national security requirements. I am particularly happy to be with this Committee.

Congresswoman Davis was the first member of Congress I met upon assuming my present duties, and I last saw Congressman Schrock on Election Day 2000 at All Saint's Episcopal Church in Virginia Beach when we were both doing our part to get out the vote. And, of course, Lieutenant

Commander Kirk was a fellow Reserve Officer in the Office of Naval Intelligence.

But I would be remiss if I didn't pay tribute to the many fine members of our defense industrial base who live and work in your states and districts. As I have visited much of our industrial base since joining the Administration, I am again and again reminded of how lucky we are to have these citizens and this workforce that are the lifeblood of our defense industrial base.

My staff and I are also proud to be able to shape the structure of the industry to meet current and future war-fighter needs, as well as to influence major tenets of the Administration's policies on the industrial base. But some of our government-industry team's finest moments have been in the immediate aftermath of 9/11, when we responded with speed and agility to the demands of Homeland Defense and Operation Enduring Freedom. Over the long term, we are also confident that our ongoing studies will help inform the future acquisition and budgetary decisions which will determine tomorrow's defense industrial base.

But now to the facts. In 2001, we reviewed 28 merger and acquisition cases. We and the regulators had little issue with the majority of them, but two were withdrawn by the parties involved and in one case, the

Department of Justice on our recommendation, blocked the acquisition of Newport News Shipbuilding by General Dynamics. We reviewed 55 CFIUS cases last year, and have reviewed 11 this year. While none of the 55 cases reviewed in 2001 were denied, three were withdrawn by the merging parties based on concerns we raised. Further, one required a Presidential Investigation, after which the acquiring party agreed to a targeted divestiture to address our concern.

During crises, we have special responsibilities related to the readiness of the defense industrial base. This was never more apparent than after the events of 9/11. Let me spend a moment discussing our staff's involvement in Homeland Defense and Operation Enduring Freedom.

The events of 9/11 posed the immediate challenge to reinforce physical security. The identification and prioritization of key assets of our defense industrial base was accomplished within days of the strikes on the Twin Towers and the Pentagon. This information is now an integral part of Homeland Defense and contingency operations plans.

We also stood up the Task Force for the Priority Allocation of Industrial Resources to ensure maximum responsiveness to the war-fighter in Operation Enduring Freedom. We redirected and accelerated key

sensor packages for Global Hawk and Predator from U.S. suppliers and allied assets. Critical components for Joint Direct Attack Munition (JDAM) and Joint Stand Off Weapon (JSOW) were indentified and funded as a result of our efforts and we are now in the process of increasing three-fold the future production of selected Precision Guided Munitions (PGM).

In each of the last several contingency operations, we have learned the hard way that to surge effectively, the maximum capacity of prime and subtier contractors must be better synchronized. As a consequence, we have considered, where appropriate, facilities expansion for selected suppliers or the establishment of second sources.

The President's FY03 budget for defense provides important reinforcement to the defense industrial base. The Administration's FY03 \$379 billion defense budget increases defense spending by about 14% over FY02, with R&D and procurement accounts each increasing on the order of 12% over FY02. The procurement budget will go to fund many of the production of systems that have been on the drawing boards for some time, and also to fund final production lots of legacy systems. These new systems will be just as essential to the warriors of tomorrow as the B-1 and B-52s have proved to our soldiers in Afghanistan.

The next generation tools of warfare will not be produced overnight. They will be forged in the next several years of Research and Development (R&D) spending as well as in spending allocated for transformational capabilities. Here it must be remembered that dollars spent in production typically are several multiples of what is spent in R&D. So it is the procurement budget of tomorrow that we are seeing foreshadowed in today's R&D budget.

Against this backdrop of robust funding and epic challenges, it is our responsibility to shape an industrial base that will supply 21st century warriors as effectively as it has prior generations of men and women in uniform. Many of our studies of Industrial sectors, such as those on space, UAVs, missiles, and the helicopter industrial base, will help with this process.

A study is also underway to survey the sources of less traditional defense solutions and the supplier base that will support these new technologies. Financial incentives must be provided to attract high margin pharmaceutical, telecom and network-based suppliers. The financial return potential of transformational technologies must be communicated to the investment community to induce investments in less traditional suppliers and technologies by institutional investors and defense firms.

On an ongoing basis, our internal financial assessments of American defense companies and global suppliers allow us to continue to take the temperature of the defense industrial base. We use these assessments in all of our programmatic decisions and in our examinations of financial restructuring initiatives within the industry. We also meet on a quarterly basis with Wall Street analysts to incorporate their views on the health of our industry.

I have been delighted to be here today to share our views, and to initiate the dialogue with you on the myriad defense industry issues that we will work together in the months and years to come.

As we set our course together toward this industry shaped for New Age warfare, there is one time-honored principle which should inform the planning of our financial and industrial resources: the requirements of our men and women in uniform. They will be the first judges of our success.

Thank you.